

ARIZONA

MONTHLY FISCAL HIGHLIGHTS

May 2006

Summary

General Fund revenue collections were \$1.2 billion in April. This is the largest single month of revenue collections in the state's history and exceeds last April, which was previously the largest single month, by 17.3%. April collections are \$161.3 million higher than the revised January JLBC Baseline FY 2006 forecast. For the fiscal year-to-date, revenues are \$291.1 million above the January forecast.

The recently introduced budget legislation included a higher FY 2006 revenue estimate than the JLBC Baseline, based on discussions between the Governor and Legislative Leadership. (*See blue May 16 Budget Proposal – Introduced Bills packet.*) The April results ran \$87 million ahead of these estimates. In addition, May individual income tax payments have been very strong and are substantially above forecast.

After two months of slower growth, collections in April rebounded to the higher rates of growth seen throughout most of the fiscal year. Of the 3 largest revenue categories, April sales tax collections were 15.7% above last year and individual income tax collections grew by 16.2%, both of which are similar growth rates to prior months. Corporate income tax collections grew at an even greater rate, increasing 60.1% over the prior year. Some of the corporate surplus, however, appears to have been early processing of May collections.

In other fiscal news this month, the JLBC met on May 2nd and the JCCR met on May 9th. A summary of the meetings can be found on pages 5 - 6. The May Monthly Fiscal Highlights also includes a summary of recent statutory reports submitted to JLBC (*see page 6*), including a report from DES on Child Protective Services' program and financial accountability.

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State of Arizona

General Fund Revenue: Change from Previous Year and January Forecast

April 2006

	Current Month					FY 2006 YTD (Ten Months)				
	Actual April 2006	Change From				Actual April 2006	Change from			
		April 2005		Revised Forecast			April 2005		Revised Forecast	
		Amount	Percent	Amount	Percent		Amount	Percent	Amount	Percent
<u>Taxes</u>										
Sales and Use	\$384,904,139	\$52,098,036	15.7 %	\$20,498,908	5.6 %	\$3,527,596,112	\$515,605,643	17.1 %	\$73,183,036	2.1 %
Income - Individual	621,374,286	86,513,100	16.2	107,183,160	20.8	2,931,110,900	469,196,032	19.1	150,459,536	5.4
- Corporate	161,883,485	60,779,734	60.1	57,993,092	55.8	671,895,045	135,488,005	25.3	71,662,876	11.9
Property	960,346	(621,250)	(39.3)	(139,654)	(12.7)	16,324,059	(418,615)	(2.5)	739,032	4.7
Luxury	6,497,881	1,754,285	37.0	824,881	14.5	55,107,938	3,059,467	5.9	610,013	1.1
Insurance Premium	33,520,456	(5,822,244)	(14.8)	(17,854,244)	(34.8)	275,567,761	13,342,836	5.1	(536,439)	(0.2)
Estate	67,964	(1,256,275)	(94.9)	(707,036)	(91.2)	11,562,911	(16,744,433)	(59.2)	(1,913,672)	(14.2)
Other Taxes	644,869	544,982	545.6	577,869	862.5	1,138,583	(1,345,341)	(54.2)	550,880	93.7
Sub-Total Taxes	\$1,209,853,426	\$193,990,368	19.1 %	\$168,376,976	16.2 %	\$7,490,303,309	\$1,118,183,594	17.5 %	\$294,755,262	4.1 %
<u>Other Revenue</u>										
Lottery	432,400	(1,510,400)	(77.7)	(67,600)	(13.5)	37,389,100	13,117,900	54.0	2,246,300	6.4
License, Fees and Permits	3,682,893	476,401	14.9	155,593	4.4	27,419,867	3,607,634	15.2	620,820	2.3
Interest	7,949,936	5,193,529	188.4	3,086,836	63.5	49,710,200	30,271,737	155.7	8,647,970	21.1
Sales and Services	2,824,533	47,935	1.7	115,233	4.3	42,142,045	6,025,281	16.7	721,242	1.7
Other Miscellaneous	210,308	(785,547)	(78.9)	(5,354,192)	(96.2)	18,998,184	1,934,001	11.3	(5,714,713)	(23.1)
Disproportionate Share	0	0	--	0	--	0	0	--	0	--
Transfers and Reimbursements	100,123	(3,956,247)	(97.5)	(5,059,877)	(98.1)	18,854,584	(17,187,401)	(47.7)	(10,131,523)	(35.0)
Sub-Total Other Revenue	15,200,193	(534,329)	(3.4) %	(7,124,007)	(31.9) %	194,513,980	37,769,152	24.1 %	(3,609,904)	(1.8) %
TOTAL BASE REVENUE	\$1,225,053,619	\$193,456,039	18.8 %	\$161,252,969	15.2 %	\$7,684,817,289	\$1,155,952,746	17.7 %	\$291,145,358	3.9 %
<u>One-Time Revenue</u>										
Urban Revenue Sharing	(35,435,744)	(4,346,362)	14.0	0	0.0	(354,357,439)	(43,463,624)	14.0	0	0.0
VLT Transfer	0	(13,385,926)	(100.0)	0	--	0	(112,324,394)	(100.0)	0	--
Judicial Enhancement	0	0	--	0	--	0	(2,120,880)	(100.0)	0	--
Sub-Total Transfers In	(35,435,744)	(17,732,288)	100.2 %	0	0.0 %	(354,357,439)	(157,908,898)	80.4 %	0	0.0 %
TOTAL REVENUE	\$1,189,617,875	\$175,723,751	17.3 %	\$161,252,969	15.7 %	\$7,330,459,850	\$998,043,848	15.8 %	\$291,145,358	4.1 %

APRIL REVENUES

Sales Tax revenue increased by 15.7% on a year-over-year basis in April and was \$20.5 million above the revised forecast for the month. The following table displays the April and year-to-date growth rates for the major categories:

Table 2**Sales Tax Growth Rates**

	<u>April</u>	<u>Year-to-Date</u>
Retail	11.0%	14.8%
Contracting	29.3%	28.1%
Utilities	20.1%	12.0%
Use	17.8%	23.2%
Restaurant & Bar	14.5%	13.1%

Of particular note was the 20.1% increase in April utilities tax collections. The high rate of growth was likely driven by large increases in energy prices. According to the most recent data from January, the price of natural gas in Arizona rose 42.5% above last year.

Individual Income Tax collections were \$621.4 million in April, a 16.2% increase from last April and \$107.2 million above the revised forecast for the month. Estimated and final payments increased 20.8% over April of last year, while refunds increased by 17.2% on a year-over-year basis. Year-to-date, total collections are 19.1% above last year.

Corporate Income Tax collections were \$161.9 million in April, a 60.1% increase from a year ago and \$58.0 million above the revised forecast. For the fiscal year to date, corporate income tax revenues have increased 25.3% from last year.

The General Fund portion of April **Luxury Tax** collections was \$6.5 million, or 37.0% above April 2005.

Among the remaining categories, as noted in the prior Monthly Fiscal Highlights, **Insurance Premium Tax** collections for March were \$15.8 million above the forecast for the month. April collections are (14.8)% below last year, and \$(17.9) million below the forecast for April. Year-to-date through 9 months, insurance premium collections are a total of 5.1% above last year, and are only \$(0.5) million below the forecast.

RECENT ECONOMIC INDICATORS

U.S. Gross Domestic Product (GDP) growth surged to a 5.3% annual pace in 2006's first quarter, the strongest reported since the third quarter of 2003. The personal consumption, equipment and software, exports and federal government spending categories all made positive contributions to the increased growth rate.

The **U.S. Index of Leading Economic Indicators** dipped (0.1)% in April. Unemployment insurance claims, manufacturers' new orders, building permits and consumer expectations were among the negative influences, while stock prices and vendor performance offset some of the losses.

The Conference Board's **U.S. Consumer Confidence Index** rose 2% in April to 109.6, its highest level since May 2002. The current conditions assessment, the outlook for the next 6 months, and labor market conditions all showed improvement.

The 3-month moving average of **U.S. semiconductor billings** increased 0.4% to \$3.73 billion in March and stood 14.9% higher than a year ago. The gains have been led by a 31% year-over-year increase in cell phone unit sales. In a separate release, the Semiconductor Industry Association reported that the industry's capacity utilization rate averaged 89.8% during 2006's first quarter.

The **U.S. Consumer Price Index (CPI)** 3-month moving average climbed 0.5% in April and was 3.5% above its level from a year ago. Although the food component was unchanged, petroleum-based energy costs soared 8.5% in April. Excluding the impact of food and fuel prices, the core CPI increased 2.3% from April 2005.

Arizona's job market continued to move forward but at a slightly slower pace than in recent months. Non-farm employment totaled 2.63 million in April, a 4.9% increase from April 2005. Construction added 26,700 jobs in the last 12 months and accounted for 22% of the jobs created statewide. Finance, business services and health care also posted strong increases. Meanwhile, the **unemployment rate** increased by 0.2% to 4.3% in April.

The Behavior Research Center's **Arizona Consumer Confidence Index** declined (7.2)% to 102.4 in 2006's second quarter. Although consumers' assessment of current job

Table 3

**General Fund Revenues
Compared to Enacted and Revised Forecasts and FY 2005 Collections**
(\$ in Millions)

	<u>FY 2006 Collections</u>	<u>Difference From May 2005 Forecast</u> ^{1/}	<u>Difference From Jan 2006 Forecast</u> ^{2/}	<u>Difference From FY 2005</u>
April	\$ 1,189.6	\$ 287.9	\$ 161.3	\$ 175.7
Year-to Date	\$ 7,330.5	\$ 894.3	\$ 291.1	\$ 998.0

^{1/} Originally enacted FY 2006 budget (May 2005)

^{2/} JLBC January Baseline Budget

market conditions improved from the prior quarter, their outlook for the next 6 months was less optimistic.

The **Arizona Tourism Barometer** dropped (7.1)% to 100.4 in March. Reduced foreign visitation was among the contributing factors.

The **Arizona Business Conditions Index** improved 5.3% to 67.0 in April. The employment component showed the most strength, while new orders and delivery times also made positive contributions. The index has remained in the mid-60s range since September 2003, corroborating the economy's steady growth pattern during the last few years.

The Real Estate Center at Arizona State University reported that the Greater Phoenix **single-family median resale home price** increased to \$264,900 in April, which was 19.9% higher than April 2005. The number of single-family homes sold was (31.5)% below last year's tally. The April **townhouse-condominium median price** matched February's record \$175,000 and was 23.2% above the level from a year ago.

The **Department of Corrections' inmate population** increased by an average of 260 inmates per month from February through April. The total population increased by 1,444 inmates from a year ago.

The number of **TANF recipients** decreased (1.8)% to 90,370 in February and was (11.4)% below the level from February 2005. The **AHCCCS caseload** increased 0.5% in May from the prior month and was (0.9)% below the level from a year ago.

Table 4

RECENT ECONOMIC INDICATORS

<u>Indicator</u>	<u>Time Period</u>	<u>Current Value</u>	<u>Change From Prior Period</u>	<u>Change From Prior Year</u>
Arizona				
- Unemployment Rate	April	4.3%	0.2%	(0.4)%
- Jobs	April	2.63 million	0.6%	4.9%
- Contracting Tax Receipts (3-month average)	Feb-Apr	\$73.0 million	(1.5)%	31.7%
- Retail Sales Tax Receipts (3-month average)	Feb-Apr	\$160.0 million	(7.9)%	12.9%
- Residential Building Permits - (3-month moving average)				
Single-unit	Feb-Apr	5,505	(0.6)%	(16.3)%
Multi-unit	Feb-Apr	1,024	(8.9)%	(15.1)%
- Greater Phoenix Existing Home Sales				
Single-Family	April	5,980	(17.7)%	(31.5)%
Townhouse/Condominium	April	1,390	(20.6)%	(16.8)%
- Greater Phoenix Median Home Sales Price				
Single-Family	April	\$264,900	0.7%	19.9%
Townhouse/Condominium	April	\$175,000	1.2%	23.2%
- Arizona Tourism Barometer	March	100.4	(7.1)%	(1.6)%
- Phoenix Sky Harbor Air Passengers	March	3.81 million	21.9%	0.3%
- Arizona Average Natural Gas Price (\$ per thousand cubic feet)	February	\$8.18	(0.4)%	32.1%
- Leading Indicators Index	February	119.7	(0.1)%	(0.6)%
- Business Conditions Index (>50 signifies expansion)	April	67.0	5.3%	0.2%
- Consumer Confidence Index	2 nd Quarter 2006	102.4	(7.2)%	10.0%
- Business Leaders Confidence Index	2 nd Quarter 2006	58.0	(3.2)%	(7.6)%
- Arizona Personal Income	4 th Quarter 2005	\$185.5 billion	1.7%	8.6%
- Arizona Population	July 1, 2005	5.94 million	3.5%	3.5%
- AHCCCS Recipients	May	1,044,795	0.5%	(0.9)%
- TANF Recipients	February	90,370	(1.8)%	(11.4)%
- DOC Inmate Growth (3-month average)	Feb-Apr	33,983	260 inmates	1,444 inmates
United States				
- Gross Domestic Product (seasonally adjusted annual growth rate)	1 st Quarter 2006	\$11.4 trillion	5.3%	3.6%
- Consumer Confidence Index	April	109.6	2.0%	12.4%
- Leading Indicators Index	April	138.9	(0.1)%	2.5%
- U.S. Semiconductor Billings (3-month moving average)	Jan-Mar	\$3.73 billion	0.4%	14.9%
- Consumer Price Index (3-month moving average)	Feb-Apr	200.0	0.5%	3.5%

JLBC MEETING

At its May 2, 2006 meeting, the Joint Legislative Budget Committee (JLBC) considered the following issues:

Attorney General – Review of Allocation of Settlement Monies – The JLBC gave a favorable review to the Attorney General's (AG) allocation plan of settlement monies totaling \$1.15 million from the Amerquest and Smart Advertising Solutions (SAS) consent judgments. A footnote in the General Appropriation Act requires JLBC review for settlements over \$100,000.

Amerquest Mortgage Company violated the Arizona Consumer Fraud Act and Arizona banking laws by engaging in deceptive loan practices to Arizona consumers between 1999 and 2005. As part of the settlement, Amerquest agreed to pay \$5 million in restitution to consumers as well as \$865,000 to the AG in costs and fees to be deposited into the Consumer Fraud Revolving Fund. The company will also pay \$35,000 in costs and fees to the Department of Financial Institutions.

Smart Advertising Solutions entered into a Consent Agreement with the AG requiring the company to pay civil penalties and fees totaling \$250,000 for misrepresenting the effectiveness of advertising sold to consumers to support their home based businesses. The \$250,000 in penalties and fees will be deposited into the Consumer Fraud Revolving Fund.

Department of Corrections – Approval of Transfer of Appropriations – The JLBC gave a favorable review to the Department of Corrections' (DOC) request to transfer \$4 million from the Personal Services and Employee Related Expenditures line items to the Overtime/Compensatory Time Special Line Item. DOC reported that the transfer was necessary in order to pay cash overtime through the end of FY 2006 as well as to make a partial payment to employees with compensatory leave balances owed to them.

The Committee deferred decision until its June meeting concerning a year-end transfer for compensatory time costs.

Department of Economic Security – Review Transfer of Appropriations and Update on Ekloff v. Rodgers Litigation – The JLBC gave a favorable review to the Department of Economic Security's (DES) plan to transfer \$1.2 million General Fund and \$2.5 million state-only Long Term Care System Fund (LTCSF) monies from the state-only Arizona Training Program at Coolidge (ATP-C) budget to the Title XIX Long Term Care (LTC) ATP-C budget. The transfer of dollars is necessary due to state-only clients now being eligible for Title XIX dollars.

The Committee also received an update on the Ekloff v. Rodgers litigation, which is a class action suit filed in June 2005 to require the state to cover incontinence briefs as a preventive measure to children under age 21 with disabilities. Prior to the ruling, state policy has been to only pay for

incontinence briefs once a child has developed skin breakdowns, sores or infections.

On March 3, 2005, the United States District Court sided with the plaintiffs, requiring the state to provide the incontinence briefs as a preventive measure. The Arizona Health Care Cost Containment System (AHCCCS) has since appealed the ruling and a stay order was granted, allowing AHCCCS to not provide briefs until June 14, 2006. Retroactive liability for the state goes back to June 25, 2005. The Governor's Office of Strategic Planning and Budgeting (OSPB) has estimated a General Fund cost of \$4.5 million in FY 2007 associated with the lawsuit.

JCCR MEETING

At its May 9, 2006 meeting, the Joint Committee on Capital Review (JCCR) considered the following issues:

Northern Arizona University Applied Research Facility – The Committee favorably reviewed the use of up to \$4.0 million in lease-purchase agreements to finance the Applied Research Facility with the standard university financing provisions. By constructing the 10,000 square foot research facility on the Arizona Western College (AWC) campus, Northern Arizona University (NAU) will be expanding its 2+2 partnership with AWC. The 2+2 partnership allows students to earn credits towards a 4-year degree while taking classes at a 2-year community college.

Laws 2003, Chapter 267 appropriated \$5.9 million per year during FY's 2008-2031 from the General Fund to NAU for debt service payments on lease-purchase agreements used to acquire research related infrastructure. In exchange, NAU is required to deposit a portion of licensing, royalty, and intellectual property income into the General Fund.

Based on an estimated 4.9% interest rate, the annual debt service payment for this project will be \$300,000 for 25 years. Including this issuance, NAU has essentially used all of its annual appropriation of \$5.9 million. With the additional building, NAU estimates its annual operating and maintenance expenses will increase by \$85,000.

University of Arizona Residence Life Building Renewal – The Committee favorably reviewed the use of \$3.9 million in system revenue bonds to replace plumbing systems in the University of Arizona (UA) Residence Life building. The \$3.9 million will be used as follows: \$0.6 million for design fees, \$2.6 million for plumbing, \$0.5 million for fire sprinklers, and \$0.2 million for project contingencies.

Based on an estimated blend of fixed rate and variable rate bonds with 6.0%-7.5% interest rates, the annual debt service payment will be \$313,000 for 25 years. The higher than normal interest rate is due to the UA's plan to repay the bonds with auxiliary dorm fee funds, which the bond market views as a more volatile revenue stream.

Arizona Exposition and State Fair Building Renewal – The Committee favorably reviewed the Revised Building Renewal Plan with the provision that any reallocation of project contingency funds be reported to JLBC Staff. Staff will notify the Committee of any significant reallocation. In FY 2006, the Arizona Exposition and State Fair received \$1,386,800 for building renewal projects. At the February meeting the Committee favorably reviewed the use of \$859,000 for 4 projects. The remaining \$527,800 was expected to be allocated to future projects. However, due to a higher than expected bid and cost increases in construction materials, the Revised Building Renewal Plan requested allocating the remaining \$527,800 to the 4 FY 2006 projects and to 1 unfinished FY 2005 project. The projects include fencing, parking resurfacing, and heating and cooling systems.

Arizona Department of Transportation Oil Storage Tanks

– The Committee favorably reviewed the oil storage tank project with the provision that the department report back to JLBC Staff with the new cost estimate after the contract is awarded. Staff will notify the Committee of any substantial change, including the number of oil storage tanks and concrete containment basins to be installed. The Arizona Department of Transportation (ADOT) was appropriated \$637,600 in FY 2006 to replace 4 oil storage tanks. The current cost projections for the 3 oil storage tanks are within the appropriated budget. ADOT expects to award the contract June 14, and complete construction within 6 months.

SUMMARY OF RECENT AGENCY REPORTS

Arizona Department of Corrections – Report on Monthly Bed Plan Update – The Department of Corrections (ADC) has been providing monthly reports to JLBC Staff updating the status of several topics:

Bed Update

- Arizona inmates currently occupy all of the 2,064 available provisional beds located at out-of-state facilities in Oklahoma and Texas.
- Inmates currently occupy all of the 92 available leased jail beds at the Coconino and Navajo county jails.
- In the transition to privatize inmate stores, prices for items have exceeded agreed-upon prices within the contract, and ADC has written to the vendor to refund the excess amount. Disagreement arose regarding the vendor's practice of rounding costs to the nearest nickel, which was similar to ADC's practice prior to the privatization of inmate stores. This practice has been discontinued, and the vendor is working to repay the overcharged amount, which it estimated at about \$45,000.

Maricopa Health Care Contract

- The department reported it was reviewing requested additional information from Maricopa Integrated Health Systems (MIHS), which was the only remaining bidder after Phoenix Memorial Hospital withdrew its bid from consideration in February. A verbal update from the department indicated that it was in the second round of

discussion with MIHS. An award date, previously expected in mid-April, has not been determined.

Community Accountability Program

- The first violator was referred to the Community Accountability Program on April 13. This program provides supervision and treatment to eligible offenders who have violated the terms of their parole or community supervision. The department previously reported that the program should be fully operational by the end of April. Following delays, inmates were enrolled beginning in late February after the contract was awarded January 18.

Department of Economic Security – Report on Arizona Works Pilot Program

– Pursuant to A.R.S. § 46-342, DES has provided reports submitted by MAXIMUS, the program contractor for the Arizona Works program, along with comparable DES data, for November and December 2005. This job placement pilot serves clients in District I-E, which generally covers the eastern part of Maricopa County.

In December 2005, MAXIMUS placed a total of 108 Arizona Works clients in full-time paid employment in District I-E, consistent with the December 2004 figure of 108. (Over the same time period, the total number of District I-E Arizona Works clients placed by MAXIMUS in all new employment placements, including unpaid work experience and community service positions, decreased by (10)%.) In December 2005, the number of DES JOBS clients placed in full-time paid employment in the rest of Maricopa County decreased by (30)% from the December 2004 figure, to 180 from 257 clients. (Over the same time period, total DES JOBS clients placed in all new employment placements in the rest of Maricopa County, including unpaid work experience and community service positions, decreased by (15)%.) As we have noted previously, because of potential differences in the demographic and economic makeup of both regions, one cannot necessarily draw conclusions about the relative effectiveness of both programs from this data.

Department of Economic Security (DES) – Semi-Annual Report on CPS Financial and Program Accountability

– Pursuant to A.R.S. § 8-818, DES has submitted its semi-annual financial and program accountability report. The latest report was due February 1; however, the report was not submitted until May 2. The report includes 7 measures specifically identified in the Special Session legislation as well as 11 other measures requested by the JLBC, including 7 new measures requested at the Committee's September 28, 2005 meeting. The highlights of this report, covering the first 6 months of FY 2006, are summarized below.

- The Child Protective Services (CPS) Training Academy enrolled 185 new case managers and graduated 167, while 181 remain in the 16-week program. This represents a 10% increase in enrollment over the previous 6 months. This increase is due in part to newly authorized case manager positions in the FY 2006 budget.
- As of December 2005, case manager caseloads were close to the department's goals in 2 of the 3 categories, based on authorized positions. Investigations were at

10.3 (goal: 10), in-home cases were at 19.3 (goal: 19), and out-of-home cases were at 20.8 (goal: 16). The number of filled positions was 684 of 979 authorized and funded positions. When considering only filled positions, caseloads are considerably higher (investigations: 15, in-home: 32.7, out-of-home: 27.5). These caseload numbers are close to those in the previous 6 months (investigations: 15, in-home: 30.5, out-of-home: 27).

- DES reports that annualized case manager turnover during the first 6 months of FY 2006 was at 25.4%, with 113 case managers leaving the Division of Children, Youth and Families (DCYF). Of those, 59 left service from District 1 (Maricopa County). For the previous 6-month period, annualized turnover was at 19.8%, losing 83 employees. The report also shows that 170 new case managers were hired.
- The percent of CPS dependency cases denied or dismissed in the last 6 months grew slightly from 0.2% to 0.3%, while the percent of Office of Administrative Hearings decisions affirming CPS case findings fell from 89.4% to 83.3%. The percent of complaints validated by the Ombudsman also grew from 13.2% to 15.1%.
- The number of children in out-of-home family placements increased from 7,250 to 7,483 in the last 6 months, while the number of congregate care placements declined from 1,871 to 1,804. DES also reports that the number of children aged 0-3 in shelter care has declined from 49 to 10 and the number of children aged 0-6 in group homes has declined from 108 to 41. The number of children in shelter care for more than 21 days also fell from 373 to 270.
- The Committee asked DES to report on the participation of faith-based organizations in providing services. DES reports the following:
 - In November 2005, DCYF, Family to Family representatives and Faith in Kids met with the Arizona Ecumenical Council.
 - In December 2005, DCYF partnered with several faith-based adoption promotion organizations to provide information about adoption at a Christmas concert.
 - In March 2006, DCYF began working with the national and local churches to develop monthly presentations of Arizona's waiting children as part of worship services.

Department of Education – Budget Status Report – Pursuant to A.R.S. § 35-131(D) and a footnote in the FY 2006 General Appropriation Act, the Arizona Department of Education (ADE) recently provided an update regarding its budget status for formula-funded and other major programs for FY 2006. In that report, ADE estimates that it will experience a \$(25.2) million shortfall for FY 2006.

ADE's current \$(25.2) million shortfall estimate is \$3.9 million less than its \$(29.1) million estimate from April 2006. The difference is primarily due to a decrease in expected formula costs for special education vouchers for FY 2006.

The current \$(25.2) million FY 2006 shortfall estimate could change considerably in next months' report, as it will reflect "final" FY 2006 budget revisions due to ADE from districts by May 15, 2006. In addition, the exact FY 2006 shortfall amount will not be known until after the close of the fiscal year because corrections to Basic State Aid funding allocations can be made after a fiscal year ends pursuant to A.R.S. § 15-915. Allocations for current year ADM growth, in particular, are subject to change after the end of a fiscal year due to ongoing data revisions and corrections.

Department of Health Services – Report on Part D Implementation Costs – The Department of Health Services' (DHS) Division of Behavioral Health reported on a policy change for the third quarter of FY 2006 that resulted in a cost of more than \$500,000. According to the report, DHS spent approximately \$4 million on drug costs associated with the implementation of Medicare Part D, which was the new federal prescription drug program that began in January. When the Part D program first began, there were many problems with its implementation, including inaccurate enrollment data and individuals enrolled in the wrong plan or no plan at all. DHS expects that the federal government will reimburse the \$4 million cost sometime in FY 2006. Because these expenditures were one-time and are expected to be reimbursed, there is no net impact to FY 2007 capitation rates.

The Executive made available \$600,000 from the Health Crisis Fund for costs associated with the implementation of Medicare Part D. According to both DHS and AHCCCS, however, none of these monies have been spent. Instead, the agencies have elected to spend their own monies on this issue. According to AHCCCS, monies from the Health Crisis Fund will be used to offset any expenditures not reimbursed by the federal government.

Governor's Office of Homeland Security – Quarterly Report on Homeland Security Funding – The Arizona Office of Homeland Security (OHS), in response to a request by the Joint Legislative Budget Committee from March 2005, has submitted a quarterly expenditure and allocation report for homeland security grant monies. The report, however, did not contain goals and objectives for each project as requested by the Committee.

This report stated that all of the \$50,401,800 received in grants by the state in Federal Fiscal Year (FFY) 2003 had been expended.

In FFY 2004, approximately \$55,721,000 of homeland security funding was awarded to Arizona. Of this amount, \$19,455,000 was reported as expended or encumbered, leaving a balance of \$36,266,000 which has yet to be spent. In the February report, the total amount of funds which were reported as encumbered or expended was \$29,078,700, which represents an overall decrease of \$(9,623,700). OHS did not provide an explanation for this decrease, and has not yet responded to an inquiry seeking clarification regarding this discrepancy. OHS noted that all FFY 2004 funds would be

encumbered by November 30, 2006 and would be expended by February 2007.

In FFY 2005, Arizona received \$41,704,800 in homeland security grants. None of these funds were encumbered, and \$3,113,500 had been expended. The amount reported as encumbered or expended in the February report was \$21,239,400, representing a decrease of \$(18,125,900). Again, we are awaiting a response to a follow-up question regarding the discrepancy. OHS reported that all FFY 2005 would be encumbered by March 31, 2007, and would be fully expended by June 2007.

OHS submitted an application for FFY 2006 homeland security funding on February 28, 2006, and expects to be notified of Arizona's allocation by June 2, 2006.

Arizona State Retirement System – Report on ASRS Board Discussion and Actions to Minimize the Contribution Rate –

A footnote in the General Appropriation Act for FY 2006 requires that the Arizona State Retirement System (ASRS) submit quarterly reports to the Joint Legislative Budget Committee (JLBC) “on the discussions and actions of the ASRS Board regarding their efforts to minimize the retirement contribution rate.” ASRS has submitted a report covering the first 3 quarters of FY 2006 as well as a summary of actions previous to FY 2006. This report is the first submitted to the JLBC, as the first 2 quarterly reports were not submitted previously. The Board has sought several legislative changes in the current legislative session, including:

- Limiting the ability of a retired member to alternate between benefit options (SB 1167)
- Changing the refund policy to provide members leaving the system a refund of only the employee contributions, with interest, and not employer contributions (HB 2101)
- Making employers responsible for costs associated with any “termination incentive program,” whereas current law only requires repayment for “retirement incentive programs” (HB 2103)
- Repealing the modified Deferred Retirement Options Plan (DROP) program (HB 2340)
- Changing the income offsets in the Long Term Disability Program to 100% of Social Security disability and retirement benefits (currently the offsets are at 64% and 83%, respectively) (SB 1169)

Of these legislative changes, the termination incentive program change (HB 2103) and the repeal of the modified DROP program (HB 2340) have been signed into law. The other bills are awaiting action in the House or Senate.

The Board has also discussed and adopted new guiding principles for the ASRS investment strategy, which included minimizing contribution rate volatility and a return to 100% funded status. The previous investment goal will now be replaced with new investment goals based on these principles.

Department of Revenue (DOR) – Report on Ladewig Expenditures – DOR reports monthly on the status of the Ladewig litigation. DOR's monthly status report shows expenditures of \$44,300 for Ladewig administrative costs in April 2006. FY 2006 Ladewig expenditures total \$57.4 million through April 2006, out of the \$58.3 million allocation. DOR estimates a total cost of \$94.8 million in FY 2007 for the third and final year of payments required by the court settlement, including \$88.8 million for taxpayer payments which is due to the taxpayers by July 21, 2006.